United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

ORIGINAL 74-1694

To be argued by
BURTON S. COOPER

United States Court of Appeals
FOR THE SECOND CIRCUIT

TITAN GROUP, INC.,
Plaintiff-Appellant,

against

HAROLD FAGGEN,
Defendant-Appellee.

BRIEF FOR APPELLEE

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October 10, 1974

Clerk
U. S. Court of Appeals
Foley Square
New York, N. Y. 10007

Re: Titan Group, Inc. v.
Harold Faggen
74-1694

Dear Sir:

We represent the appellee in the above captioned matter.

The page reference in the first full paragraph of p. 47 of our brief should read 480 F.2d at 374 (not 314).

Would you please permit the bearer of this letter to make the correction in ink on all copies of the brief that have been filed. In the event that copies have been delivered to the judges who will be hearing the appeal, would you please transmit copies of this letter to those judges so that the correction can be made.

Very truly yours,

Edward Labaton

Edward Labaton

EL:vc

cc: Lawrence Powers, Esq.

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BRIEF FOR APPELLEE

Preliminary Statement

Appellant appeals from judgments (65a, 68a)* after a non-jury trial before the United States District Court for the Southern District of New York (Tyler, J.) dismissing its complaint which sought rescission of four contracts pursuant to which appellant purchased the business formerly owned by appellee (the "Faggen Companies") and awarding judgment to appellee on his counterclaim for the

* Numerical references are to the Appendix; numerical references preceded by the letter "S" are to the Supplemental Appendix; numerical references followed by the designation "#73-1345" are to the Appendix on the prior appeal bearing that index number.

principal ($5,500,000) and accrued interest on promissory notes issued to him in payment for the stock of the Faggen Companies and for counsel fees as provided for in the notes. Appellant's claim was based on an alleged violation of Rule 10b-5 under the Securities Exchange Act of 1934 (17 CFR 240.10b-5).

The trial court rejected appellant's contention that it acquired the Faggen Companies on the strength of a handwritten summary of adjusted (or restated) earnings and narrative description of appellee's business prepared two months before the execution of definitive contracts. The court found, instead, that appellant relied upon the elaborate representations and warranties of the earnings and financial condition of the Faggen Companies which were incorporated in those contracts.

The court found incredible the testimony of appellant's two negotiators that they had relied on the informal presentation of adjusted earnings rather than the actual historical earnings represented and warranted in the contracts. It was not difficult for the trial court to reach this conclusion since these witnesses, when they were appellant's Chairman of the Board and President, respectively, approved appellant's proxy statement issued after execution of the contracts, which proxy statement described the transaction as one reached after arm's length negotiations and after thorough investigation of the financial condition and earnings history of the Faggen Companies (1542). In addition, one of these witnesses, appellant's former Chairman of the Board, was and is a lawyer specializing in mergers and acquisitions (176). It was he who, after making the deal with appellee, prepared the first draft of the contract and reviewed all subsequent drafts (246, 250). Neither his first draft nor the later ones referred to any restatement of earnings. Not once did he suggest that they be a subject of contractual reprseentations and warranties and not once in

the three and one-half years between the execution of the contracts and this action, did he claim that he or appellant had been misled by appellee.

The Facts

The stock of appellee's four actuarial companies was acquired by appellant, a publicly held real estate conglomerate, in exchange for ten year convertible subordinated promissory notes in the principal amount of $5,500,000 with interest at 4% with amortization to commence in the sixth year, pursuant to four voluminous, meticulously drafted contracts (Exhibit 4; 69a-95a #73-1345) executed on December 2, 1968. At the time of acquisition, the Faggen Companies had, in addition to the assets necessary to conduct its business, a securities portfolio whose value exceeded $1,300,000 which appellant promptly transferred to itself upon acquisition.

Three and one-half years later, in May 1972, after a succession of management changes arising out of a series of financial crises unrelated to the Faggen Companies' operations, appellant defaulted on an interest payment due appellee on his notes and simultaneously commenced this lawsuit. It was the culmination of concerted efforts commenced in 1971, and led by Robert J. Frankel, who became appellant's chief executive officer in February of that year, to coerce appellee to convert his notes into stock, the market value of which had substantially declined (see pp. 12-14, *infra*).* However, before analyzing

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* "The Chairman then described his efforts to convince Mr. Faggen to restructure his interest in the Company. He commented on the effect of the debentures on possible merger, bonding capacity and profit position. He stated that as a result of Mr. Faggen's refusal to consider such restructuring, the Executive Committee had caused an investigation to be made to determine whether or not there was some basis for setting aside the transaction in which the debentures had been issued." (Minutes of Board Meeting September 14, 1971 459a #73-1345)

appellant's motives and conduct in bringing this action, it is appropriate to discuss the transaction itself.

Edmund Kaufman became appellant's Chairman and chief executive officer in April 1969 and served as a director from December 1968 until May 1971. He was a California lawyer with a background in accounting and a specialist in corporate mergers and acquisitions. In September 1968, he was engaged as appellant's special counsel to negotiate the transaction. Kaufman had been counsel to, and a general partner of, a syndicate known as the "Block Group", which acquired control of appellant in the spring of 1968. (103) This same syndicate was responsible for the appointment of Anthony Frank, as President of appellant. (104) Frank and Kaufman negotiated the transaction with appellee.(974 *et seq.*)

Benjamin Robinson, a New York lawyer specializing in union pension and welfare funds, and a senior partner in the firm of Robinson, Silverman, Pearce, Aronsohn, Sand & Berman, had been chairman of appellant's board for many years before the entry of the Block Group. (329) He had known appellee professionally in connection with the actuarial services which the Faggen Companies performed for pension and welfare funds which he served as counsel. Robinson, as chairman of appellant's board, in the early summer of 1968 introduced appellee, as a candidate for acquisition, to Frank (274, 329)* but declined to participate in negotiations because of their close relationship. (332) Frank was of the opinion that the Faggen Companies would make a good mix with appellant. He then arranged for Kaufman to be designated to

* Early in 1968, the appellee, then approaching retirement age, determined to sell his business. Prior to negotiations with appellant, he had met with representatives of several companies, including Price, Waterhouse & Co., Levin-Townsend Computer Corp. and John Diebold, Inc. (30-31).

meet with appellee to evaluate the Faggen Companies and, if feasible, to negotiate a deal.

Since appellant was always in need of cash (397) one of the principal attractions of the Faggen Companies was its liquidity. It had a securities portfolio readily convertible to cash worth more than $1,300,000, and not necessary for the operation of its actuarial business; in addition, it had assets of about $700,000 (including more than $250,000 in cash and certificates of deposit). (1677) The Faggen Companies were an attractive acquisition for other reasons as well:

Over a number of years, the Faggen Companies had acquired a reputation as a leading actuarial business performing services primarily for union pension and welfare funds.*

The income tax returns of the Faggen Companies (included in Exhibit 4) reported historical net income of all the Faggen Companies before federal income taxes to be:

Fiscal Year Ended In	*Net Income*
1968	$364,975
1967	246,306
1966	352,302
1965	257,780
1964	229,935

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* Appellant's annual report for 1969, disseminated a year and a half after the transaction, and during Kaufman's tenure as Chairman of the Board, described the Faggen Companies as follows:

> The Harold Faggen Companies, one of the nation's prominent actuarial, consulting and computer service organizations, continued its profitable growth during 1969. Headquartered in New York City, the Faggen operation provides computerized pension and welfare fund administration to multi-employer union pension funds providing benefits to over 1,000,000 persons. (1526)

Kaufman first met appellee on September 6, 1968, at which time Kaufman was given a copy of the income tax return for the largest of the Faggen Companies, Harold Faggen Associates, Inc., for the fiscal year ended June 30, 1968. Appellee described some of the acquisition proposals that had been made to him; particularly his negotiation with another public company, John Diebold, Inc. ("Diebold"), wherein Diebold proposed to acquire the Faggen Companies for stock based upon a multiple of earnings plus the net worth of the Faggen Companies. The negotiator for Diebold (Rogov) had, together with appellee, worked up a summary of what the Faggen Companies' earnings might have been in 1968 had they then been owned by Diebold (65). Kaufman reviewed this summary (1342-43) with appellee and made a copy of it (34). Some of the items appearing in this summary (the "Diebold Memorandum"—Exhibit 1) were questioned by Kaufman and appellee agreed that some of its underlying assumptions were inappropriate, particularly those that made accrual adjustments to cash basis tax returns. (59) The meeting closed with Kaufman expressing an interest in pursuing further the possible acquisition of the Faggen Companies. (128)

A second and final meeting with Kaufman was held on October 2nd at the office of the Faggen Companies in New York. Present were Kaufman, Frank and appellee. (974, 131) Appellee produced copies of all of the income tax returns filed by the Faggen Companies for the previous five fiscal years, as well as the client ledger and various employee records. (975)

Appellee, Kaufman and Frank went over the tax returns. (975) They hypothesized a series of changes to the net income of the Faggen Companies shown on the tax as

it might have been had appellant owned the Faggen Companies during the years covered by the tax returns. Generally, private companies operate in a maner to reduce income and thus taxes. Public companies usually attempt to maximize earnings in order to increase the market price of their shares. They thus translated the earnings of the Faggen Companies, as privately held companies, into what the earnings of those companies might have been had appellant, a public company, then owned them. (975 *et seq.*)

Appellant's brief suggests an element of mystery in the five adjustments that were discussed. Not so. As Kaufman admitted, most of the adjustments could be taken directly from the Faggen Companies' tax returns. (266-67) The five adjustments related to pension overfunding, salaries, city and state income taxes, expense items that would not have been incurred by a public company, and accounting fees earned personally by appellee, and thus reported only on his personal tax returns. Each of these items, except for appellee's personal accounting fees which had been earned for work performed by appellee on behalf of funds serviced by the actuarial companies, appeared on the Faggen Companies' tax returns.

The amounts paid toward the pension fund were reported on the tax returns (see, e.g., 1344, item 25a), as were the salaries (1345), the city and state income taxes (1348), and the specific expense items. (1348) So far as the personal accounting fees were concerned, appellee described them to Kaufman and Frank and they are shown separately on Exhibit 2. (1360)

In the fiscal years ended in 1968, the Faggen Companies had made pension contributions of approximately $64,-000. (976)* These payments were optional. Since the

* The figure "$158,000" at line 17 of p. 976 of the appendix should read "58,000".

pension funds were substantially overfunded, the contributions were not necessary and therefore these expenditures would not have been made, and would have been added to the income of the Faggen Companies had appellant owned them. City and state taxes were $21,000. Since it was contemplated that income was to be computed before all income taxes, the $21,000 was added back as an adjustment to the income shown on the federal tax returns. (976) The salaries for appellee and Rose Dogan were $87,000 and $50,000, respectively. Since the deal contemplated that their salaries were to be reduced to $50,000 and $40,000, respectively (303a, #73-1345) they would have been at the latter rates in 1968 if appellant had owned the companies. The aggregate reduction $47,000, was added back as an adjustment to the income. (979) Kaufman and appellee agreed (977-78) that $37,-000 was an appropriate adjustment for expenses items such as apartment rent, boat, automobiles, and non-recurring legal fees which would not have been incurred had appellant owned the Faggen Companies in 1968. This, too, was added to the income of the Faggen Companies as shown on the federal tax returns. The personal accounting fees received by appellee in 1968 were $35,280. Since an amount equal to the personal accounting fees would have been paid over to the Faggen Companies by appellee if the Faggen Companies had been owned by appellant, they, too, were added as an adjustment to the income for those companies as shown on the federal tax returns for 1968. (978) When the Faggen Companies' earnings for 1968, as shown on the federal tax returns, were thus adjusted, the net income-pretax for the 1968 fiscal years was raised from $365,000 to $571,000. The same procedure was followed, in less detail, for each of the earlier years. (980)

When Kaufman and Frank satisfied themselves that had the Faggen Companies been owned by appellant their earnings would have been in excess of $500,000 in 1968, Kaufman offered appellee ten year 4% convertible notes in the principal sum of $5,500,000 in exchange for the stock of the Faggen Companies. (981) Appellee assented to Kaufman's terms and they shook hands on the deal.

Kaufman requested that appellee, together with Frank, work up a memorandum showing the bottom line for four years adjusted along the lines that they had discussed, together with a brief description of the Faggen Companies. (983-84) Some time before October 9th, the date of appellant's next board meeting, the memorandum was completed (Exhibit 2, 1356-1361). Frank had the memorandum typed and it is that document (Exhibit 3, 1368-1372) which forms the basis of appellant's claim.*

When the board met on October 9th, the Faggen Companies' acquisition was discussed but Frank did not distribute Exhibit 3 to the board members. (392, 516-17) The minutes of that meeting are totally silent with respect to any discussion of the earnings of the Faggen Companies. (191a-192a, #73-1345) Several of the board members testified that they recalled being told that the earnings were in the range of $450,000 to $550,000 (390-391, 368, 516, 588) but, and more importantly, they recalled being told that the securities portfolio of the Faggen Companies was something in excess of $1,000,000. (589,

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* Appellant's brief (p. 5) characterizes the document as "the selling memo". The phrase is an invention of appellant's counsel. The document was used to sell no one. It was prepared after the parties had agreed in principle on a deal and it was neither distributed to appellant's board nor was it ever seen by appellant's principal negotiator until this lawsuit was started. (214)

391, 370) The board approved the transaction in principle on October 9th, subject to the executive committee's analysis of the financial details of the transaction (396, 521) and its final approval. (192a, #73-1345)

Kaufman prepared the first draft of the contract (139), which made provision for conventional certified financial statements for a period of five years up to 1968. (1557) Clearly, financial statements of this kind would have reflected the actual, not the restated or adjusted, earnings.

Kaufman prepared and delivered the first draft of the contract with the express understanding that he would be consulted with respect to all aspects of the transaction. (348, 418). He arranged for Michael Rosen, an associate in Robinson's law firm, to attend the various meetings with appellee's lawyers and to re-draft documents so that he could avoid trips to New York. (348)

Shortly after the first draft was received by Rosen, it became clear that no certified financial statements had ever been prepared for the Faggen Companies and the parties had to come up with an acceptable alternative. (429) It was determined that the Faggen Companies' income tax returns, together with brief "stub" period statements for the portion of the year from the end of the fiscal years ending in 1968 to September 30, 1968, would be used as the financials represented in the contract documents—that these would be the sole financial representations. (429) Rosen prepared a re-draft which included that change, among others. (444-5) He marked the changes in red pencil and mailed a copy of the redlined revision to Kaufman (444-5), who approved them. (250) Robinson did not participate in any of the contract drafting and, in fact, was out of the country during most of this period. (431) As the lawyers moved toward closing, Frank designated McIntyre, appellant's Treasurer, a certi-

fied public accountant and a member of appellant's Board of Directors, to check the validity of the adjustments to the income tax figures. McIntyre reviewed with appellee each of the adjustments (1478, 1423; 340-342a #73-1345) and found them to be reasonable. (1478)

On December 2, 1968, the transaction closed. Shortly thereafter, appellant received from appellee securities which on December 31, 1968 had a market value of $1,368,000. (101a-110a #73-1345; 200, 298, 581, 602, 1677) Thereafter, additional monies in excess of $700,000 were taken by appellant from the Faggen Companies. (1390)

Kaufman and Frank became appellant's principal witnesses in support of its Rule 10b-5 claim. Their credibility was examined by the trial court and found wanting. It is thus appropriate to examine their conduct after acquisition.

In April 1969, Kaufman became Chairman of appellant's Board and its chief executive officer. (154) In May 1969, appellant filed with the Securities and Exchange Commission and disseminated to the investing public a proxy statement prepared or reviewed by Kaufman. (212) Frank and Robinson also testified that the proxy statement was true. (317, 372) It stated:

> The Amount of Convertible Installment Notes delivered to Mr. Faggen was arrived at as a result of arms-length negotiations between the parties, with each side separately represented by counsel, based upon the financial condition and past earnings history, and after a thorough investigation of the business and assets of the companies acquired from Mr. Faggen. (1542)

In view of the proxy statement, the appellant's belated attack on the bona fides of this transaction is incredible,

particularly since appellant's case was based on Kaufman's and Frank's testimony.

After the acquisition and at the direction of appellant's management during the period in which Kaufman was Chairman and Frank was President, the Faggen division was committed to a substantial and costly expansion of its data processing operations (see pp. 31-32, *infra*). Parenthetically, it should be noted that this costly expansion notwithstanding, the Faggen Companies continued to be profitable during the period of Kaufman's tenure, which ended in the summer of 1970, and he so reported to appellant's shareholders. (1526)

In April 1970, Kaufman was aware that appellant had issued an estoppel letter to appellee's first wife in connection with a matrimonial settlement. The letter attested to the fact that the notes issued by appellant to appellee were a valid and subsisting obligation of appellant. (111a #73--1345) The date of issuance of this estoppel letter is significant because the contracts, by their terms, provided for a shortened statute of limitations, March 31, 1970, after which appellant could not claim any misrepresentation or breach of warranty. (80a #73-1345)

In February 1971, Robert J. Frankel became appellant's Chairman and chief executive officer. (878-879) Shortly thereafter, he launched an attack against Kaufman in connection with the latter's involvement in appellant's 1968 Yosemite acquisition which had resulted in a $2,600,000 loss to appellant. (172, 182) He accused Kaufman of a

breach of fiduciary duty and conflict of interest. (458a, #73-1345) By 1971, appellant owned Kaufman's law firm the sum of $133,000 for legal fees incurred while he was Chairman. (209) Almost contemporaneously with this attack, Frankel commenced the campaign against appellee seeking to coerce him into a conversion of his notes into stock, to relieve appellant of its debt burden. (402a, 459a #73-1345) Frankel was present when appellant's President and chief operating officer threatened appellee that if he did not convert to an equity position they would take out all of the cash and reduce the appellant to a shell. (906-907)

At the board meeting of May 13, 1971, one year before the commencement of this action, Frankel announced that appellant had defaulted on an interest payment to appellee. (403a, #73-1345)* Kaufman, who was still a member of the Board, submitted his resignation and protested this action by Frankel. (422a, #73-1345) Frankel immediately cured the default.

When by September, 1971 the various threats failed, Frankel retained counsel* to commence an action against Benjamin Robinson and appellee in order to compel Robinson to put pressure on appellee to negotiate. (914-915) Frankel had the proposed complaint read to the Board. When Robinson threatened to hold the board members responsible for any such action (459a-460a #73-1345), appellant refrained from commencing the action.

Shortly thereafter, Frankel settled Kaufman's claim for legal fees for 10,000 shares of restricted stock of appel-

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* This was the first of his attempts at coercion to compel appellee to convert. Among the last of such efforts was the default on interest payments contemporaneous with the institution of this lawsuit.

lant, then worth about $15,000 (921-924), dropped appellant's conflict of interest claim against Kaufman and procured Kaufman as a witness against appellee. (924)

At no time during Kaufman's tenure as board member or Chairman did Kaufman ever claim, or even suggest, that appellant had been misled by appellee. (40). At no time prior to the institution of this lawsuit did Kaufman question the bona fides of the Faggen acquisition. Neither did Frank.

Appellant's complaint, in a patent distortion of the legend on Exhibit 2,* alleged that the summary contained therein represented the actual pretax net income of the Faggen Companies "adjusted to accounting conditions (accrual basis) which would prevail after the acquisition. . . ." (7a, #73-1345)**

At the trial, the appellant abandoned these contentions since appellant's witnesses acknowledged that the summary in Exhibit 2 was not a statement of *actual* historic "Net Income—Pre-Tax" but rather a summary based upon adjustments. Unable to challenge the basis upon which

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* The caption prepared by appellee (1360) stated: "Net Income—Pre-Tax Adjusted to Basis Which Will Prevail After Acquisition". There was no reference to accrual basis. Nor was there any reference to accounting conditions.

** A second count sought relief on the ground that appellee wrongfully withheld books and records of the Faggen Companies. No evidence whatever was offered on that count and in fact the documentary evidence demonstrated that the claim was patently sham in that appellant five days before the verification of the complaint acknowledged that it had all of the books and records. (253a-255a. #73-1345)

the summary had been prepared, appellant in the court below shifted its ground to challenge the bona fides of the adjustments by arguing that they were not prepared in accordance with generally accepted accounting principles. It completely ignored the fact that appellee prepared the summary in accordance with appellant's instructions, and that appellant's negotiators had thoroughly discussed the adjustments which would be made, and, indeed, had participated in calculating and making those adjustments. (976 et seq)

Summary of the Court's Findings

After a trial which consumed ten trial days, the court made the following findings of fact:

1. Appellant pursuant to contract bought the stock of the Faggen Companies on the basis of financial statements in the tax returns for five fiscal years ending in 1968, and stub period statements for the interim periods ending September 30, 1968. (S-12a-13a)

2. The contracts executed by the parties on December 2, 1968 (including the financial statements appended thereto) contained no materially false or misleading statements nor did they omit to state material facts necessary to make the statements made not misleading. (S-13a)

3. As between appellant and appellee, in the negotiations, the balance of sophistication and "know-how" rested heavily in favor of appellant. (S-27a)

4. Following the closing, and between 1968 and 1972, appellant withdrew more than $2,000,000 in cash and securities from the Faggen Companies. (S-16a)

5. At the October 2, 1968 meeting, Kaufman reviewed each of the tax returns of the Faggen Companies. (S-6a)

6. On the basis of his own review of the tax returns, Kaufman estimated that the adjusted pre-tax income of the Faggen Companies would be about $550,000. (S-7a)

7. At the appellant's Board of Director's meeting held on October 9th, it voted to acquire the Faggen Companies, subject to the Executive Committee's investigation and approval of the financial and other details of the transaction. (S-11a)

8. At the October 9th meeting, the Board did not have the memorandum containing the summary of adjusted earnings (Exhibit 3) and did not discuss any items of adjustment. (S-10a)

9. Following the directors' meeting, McIntyre investigated the earnings of the Faggen Companies and the adjustments thereto, made inquiries and studies of the adjustments and satisfied himself and appellant as to their validity (S-12a, S-35a-36a).

10. Appellant was aware that the bottom line adjusted earnings figures in Exhibit 3 included investment income (S-32a-33a).

11. The adjusted figures in Exhibit 3 were substantially accurate (S-35a-36a).

12. There were no false or misleading statements relating to the data processing capacity of the Faggen Companies and Exhibit 3 was not construed as indicating that programs were completed (28a-29a).

13. There were no material misstatements or omissions regarding customers in that appellant was not interested

in specific customers, was aware that customers would be lost in the ordinary course of business and, in fact, did nothing when, within a month after the closing, a disgruntled employee took some customers from the Faggen Companies (S-14a, 29a).

14. Appellant was aware of the relationship between appellee and Robinson. (S-30a)

15. Following the closing, the actuarial business of the Faggen Companies continued to be strong (S-14a).

16. Appellant did not rely upon Exhibit 3 or the adjusted income summary referred to therein (S-10a-12a).

17. Appellee made no materially false statements nor did he omit to state material facts necessary to make the statements made, in the light of the circumstances under which they were made, not misleading (S-37a-38a).

Questions Presented

1. Was there clear error in the trial court's finding that the appellant made its purchase and issued notes on the basis of the contractual representations and that appellee made no material misstatement or omission?

2. Assuming, arguendo, a material misstatement or omission, did the court err in holding that appellant had the burden of proving, and failed to prove, reliance in its 10b-5 case?

3. Where appellant had defaulted on its promissory notes issued to appellee for value, was it error for the trial court to award judgment on appellee's counterclaim for the principal amount of the notes, plus accrued interest, together with attorneys' fees incurred in the collection thereof when by their terms the promissory notes contained an acceleration clause and provided for the payment of attorneys' fees?

POINT I

The evidence supported the Trial Court's findings of fact.

On its appeal, appellant calculatingly ignores the contracts (Exhibit 4) with their representations and warranties of the Faggen Companies' earnings; ignores the fact that appellant's auditors verified the represented net income of appellee's companies; ignores the fact that every one of the representations was true; (p. 21, *infra*), and ignores its 1968 proxy statement describing the transaction (1542). Instead, it claims that the $5,500,000 of its notes were exchanged for the stock of the Faggen Companies on the strength of a handwritten memo delivered two months before the contracts were signed.*

Appellant chooses to overlook the fact that the minutes do not contain any reference to the memo or to the restated earnings contained therein; that the Board's approval of the transaction in principle was subject to the final approval of the contracts by appellant's Executive Committee. (191a-192a, #73-1345) It disregards the fact that Frank failed to advise the Board that the earnings reported to it were on a restated basis and that no one explained the manner in which the restatement was arrived at.

In *United States* v. *Aluminum Co. of America,* 148 F.2d 416, 433 (2d Cir. 1945), this court (L. Hand, J.) discussing Rule 52(a) Fed. R. Civ. P. held:

> It is idle to try to define the meaning of the phrase, "clearly erroneous"; all that can be profitably said

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* In *Value Line Fund, Inc.* v. *Marcus,* CCH Fed. Sec. L. Rep. ¶91,523 (S.D.N.Y. March 31, 1965), upon which appellant heavily relies, the exchange took place without representations or warranties or, indeed, any contract other than a purchase confirmation. Such a transaction is clearly distinguishable from the one at bar.

> is that an appellate court, though it will hesitate less to reverse the finding of a judge than that of an administrative tribunal or of a jury, will nevertheless reverse it most reluctantly and only when well persuaded. This is true to a considerable degree even when the judge has not seen the witnesses. His duty is to sift the evidence, to put it into logical sequence and to make the proper inference from it. . . .
>
> However, whatever may be said in favor of reversing a trial judge's findings when he has not seen the witnesses, when he has, and in so far as his findings depend upon whether they spoke the truth, the accepted rule is that they "must be treated as unassailable". Davis v. Schwartz, 155 U.S. 631, 636, 15 S. Ct. 237, 39 L. Ed. 289; Adamson v. Gilliland, 242 U.S. 350, 353, 37 S. Ct. 169, 61 L. Ed. 356; Alabama Power Co. v. Ickes, 302 U.S. 464, 477, 58 S. Ct. 300, 92 L. Ed. 374. The reason for this is obvious and has been repeated over and over again; in such cases the appeal must be decided upon an incomplete record, for the printed word is only a part, and often by no means the most important part, of the sense impressions which we use to make up our minds.

See also *United States* v. *Yellow Cab Co.,* 338 U.S. 338, 341 (1949)

Analysis of the Evidence Supporting the Court's Findings of Fact

The court's findings that:

(1) Appellant based its determination to buy the Faggen Companies on the strength of the tax returns and the stub period statements (S-12a-13a)

and

(2) There was no evidence that the contracts contained materially false or misleading statements (S-13a)

and

(3) As between appellant and appellee the balance of sophistication and know-how rested heavily with appellant (S-27a)

* * *

The court found that between October 9, 1968 and December 2, 1968 the parties agreed that

> Titan would buy the Faggen companies against the tax returns for the last five fiscal years of those companies and also against the unaudited financial statements of the companies prepared by Joseph Warren Company, a certified public accounting firm, for the quarter ended September 30, 1968. (S-12a-13a)

The contracts (Exhibit 4) each contained similar representations and warranties relating to income and financial condition. References to financial condition are made in ¶¶ 3.1, 3.5, 3.8, 3.9 and 3.21 of each contract (62a-73a #73-1345). The key representation is ¶3.1, which incorporates by reference financial statements contained in the income tax returns, together with the stub period statements, and represents that the statements are accurate, present fairly the results of the operations and were prepared in conformity with generally accepted accounting principles. (62a, #73-1345) The provision for the incorporation of the financials contained in tax returns was made in consultation with Kaufman (418, 444-5) and superseded Kaufman's draft which contemplated the

presentation of conventional certified financial statements (1556-1557).*

The court found "parenthetically, but importantly" that "plaintiff has not even attempted to offer . . . any persuasive evidence that those particular contract document financial statements as set forth in paragraph 3 of the contracts of acquisition contain anything of significance or materiality which was false or misleading at the time they were made" (S-13a).

Indeed, Kaufman was aware (254), and each of the appellant's financial experts conceded, that the financial statements incorporated in the contracts were accurate in all respects (564, 654, 705). An analysis demonstrating the accuracy of the financial representations in the contract appears at 362a-363a #73-1345.

In the negotiations, appellee represented himself. Although trained as a lawyer, he never practiced and knew nothing about mergers or acquisitions. (28)

Kaufman, on the other hand had participated as a specialist in more than 300 mergers and acquisitions. (176-177, 250-51) He had also been trained as an accountant and had passed the certified public accountant examination (198). Frank, who, prior to his connection with the appellant, had been an executive in the savings and loan business, had substantially greater knowledge of data processing than appellee (987).

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* Conventional financials would have shown substantially the same results in that here was no provision either in Kaufman's draft or in any other draft for restated or adjusted earnings. Nor did Kaufman make any reference to investment income in his draft.

(4) The court's finding that between 1968 and 1972 appellant withdrew more than $2,000,000 in cash and securities from the Faggen Companies (S-16a)

• • •

Appellant's Exhibit 12 (1390) admits that after acquisition appellant took $2,009,252 in cash and securities from the Faggen Companies.*

Exhibit 12 writes down the stock of appellant held by the Faggen Companies because the stock was arbitrarily designated by it as "investment stock". (582-83) The stock when held by the Faggen Companies was free stock and was valued as such by appellant's independent accountants at the time of the closing. (602, 1677)

(5)–(6) The court's findings that Kaufman reviewed the tax returns and the adjustments and determined that on an adjusted basis the income of the Faggen Companies was about $550,000 (S-6a, 7a)

• • •

Kaufman testified that he examined the tax returns on October 2, 1968 or prior thereto. (132, 255) He reluctantly admitted that he was generally aware of the adjustments and that they were discussed at the October 2nd meeting. (257-261) Among the items discussed were pension overfunding, travel and entertainment, salaries and

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* Exhibit 12 charges to appellee salaries paid to appellee and to Rose Dogan (who he married two years after the transaction) of approximately $500,000. As appellee has noted time and time again in this litigation, the salary and expense payments were paid directly from the Faggen Companies and if appellant proposes to debit appellee for those payments, then the cash and securities which appellant received from the Faggen Companies must be correspondingly increased (571a, #73-1345).

personal accounting fees (259-262). Most of the adjustments could be made by a skillful person right off the tax returns. (266-67) Appellee's testimony was unequivocal. On October 2nd at 9:00 A.M. Kaufman and Frank met with appellee at his office and the financial statements contained in the tax returns were reviewed, line by line. Each of the items to be adjusted was noted and the parties agreed on the adjustments. (974-980) Kaufman and Frank acknowledged that the 1968 adjusted income of the Faggen Companies was in excess of $500,-000. (980)

(7) The court's finding that appellant's Board of Directors voted to acquire the Faggen Companies subject to investigation and approval of financial and other details by the Executive Committee (S-11a)

* * *

Frank testified that he was aware that there was a need for verification of adjustments. (321-22) Director Frager testified that the Board left to the Executive Committee the responsibility for reviewing the financials. (396) Director Casey testified that the Executive Committee was to determine profitability. (521)

On October 9, 1968, the Board of Directors approved the transaction subject to the approval of the Executive Committee (192a #73-1345) and its analysis of the financial details of the transaction. (396, 521)

(8) The court's findings that the Board did not discuss adjustments to income (S-10a)

* * *

Appellant's brief, beginning at p. 48, suggests that the court's statement that there was no discussion of earnings

meant that earnings were not mentioned at the Board meeting. As the colloquy which immediately followed the rendering of the opinion makes clear (1181), this is a distortion of the court's opinion on this subject. Earnings were stated by Frank, but they were not discussed. No Board member testified that there was a discussion of earnings. Each recalled that a figure was mentioned, but the recollections varied as to precisely what that figure was. More important, there was no discussion about adjustments to earnings. In no case did any Board member testify that he heard mentioned earnings of $571,-000 for 1968 (the figure shown on Exhibit 3). Obviously, therefore, Frank did not refer to Exhibit 3 when he mentioned earnings to the Board. Frank never disclosed to the Board how the earnings figures were arrived at, even though he was aware that they were the results of adjustments to income. (278) The Board could not have relied upon the earnings being exclusive of investment income since there was no evidence that Frank told the Board that the earnings excluded investment income. Indeed, Frank testified that he had no recollection as to whether he ever told the Board that the $500,000 or $550,000 in earnings which he reported to it was actual or restated. (305-6, 313)

As the court observed, the minutes of the October 9th meeting of the Board of Directors make no reference whatever to the earnings of the Faggen Companies, let alone a discussion of adjustments. (191a-192a #73-1345; S-10a-11a)

For appellant to argue that it relied upon the adjustments contained in the Diebold memorandum (1341-2), or that those adjustments were material (Brief for Appellant at 14-16) is absurd since there is no evidence whatever that Kaufman communicated any of the contents of the Diebold memorandum to any member of the Board, including Frank.

We note, parenthetically, that the court found that appellant's need for cash was a prime motivation of the directors. The testimony made it clear that the pool of liquid assets was an important element in the transaction. For example, Director Frager testified that from its inception appellant was "always fighting for a cash position" (397); Director Grunebaum testified that appellant always had a need for cash and that the asset position of the Faggen Companies was of importance in the transaction (589); Robinson testified that appellant was "always tight for funds". (370)

(9) The court's findings that McIntyre made an investigation of the adjustments (S-12a, 35a-36a)

* * *

McIntyre was directed by Frank to look into the adjustments to determine whether the summary of adjusted earnings was valid. (322) McIntyre knew that pension overfunding, salaries, city and state taxes, travel and entertainment expenses, and appellee's accounting fees were the adjustment items. (336a-347a #73-1345; 1423) So far as McIntyre was concerned, investment income was not excluded. McIntyre satisfied himself that the pro forma figures "came within the ball park" and he so reported to Frank. (1478, 1480)* It was not appellee's responsibility

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* Appellant's brief (p. 23) criticizes Judge Tyler for his finding that appellant's real concern was to make sure the pro forma figures were within the "ball park" and it quotes from pp. 1468 and 1478 of the transcript. The court's recollection of McIntyre's testimony was, in fact, superior to appellant's analysis after it had the opportunity to review the transcript. McIntyre testified that he spoke to Frank and told Frank that he had "checked the tax returns and that other than that, and—outside of accounting income when it all added up it came within the ballpark and seemed to be what the projections were . . . ." (1480)

to determine the scope or extent of McIntyre's investigation.

10) The court's finding that appellant was aware that Exhibit 3 did not deduct investment income (S-32a-33a)

* * *

The court found that Kaufman was aware of all the adjustments and was aware that the figures were not based upon a deduction for investment income.* The appellant argues (Brief for Appellant at 17-19, 27) that the Diebold memorandum (1342-43) made a deduction for investment income and there was no writing that specifically stated that investment income was not included in Exhibit 3. (1371) Appellant never proved that Exhibit 2 was derived from the Diebold memo (Exhibit 1). Appellee testified unequivocally that the figures included in Exhibit 2** were arrived at by Kaufman, Frank and appellee, working off the tax returns (988)—that the bottom line figures in the tax returns (which included investment income) were the starting point and that investment income was not excluded. (988, 991) Buttressing appellee's testimony was McIntyre's recollection that investment income was not excluded. (339a #73-1345)

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* The investment income was the income from the $1.3 million securities portfolio acquired by appellant as part of the package. It amounted to:

Tax Year	*Investment Income*
1965	$36,377
1966	78,582
1967	30,522
1968	51,777 (1384)

** Exhibit 3 was typed from Exhibit 2 by appellant. Exhibit 2 made no reference to investment income.

Kaufman himself supplied the explanation for the exclusion of investment income in the Diebold memorandum and its inclusion in Exhibit 2. The Diebold memorandum contemplated a transaction whereby appellee would be paid a specific price for his actuarial business *plus* an amount equal to the net worth of the business, which net worth consisted primarily of the securities portfolio. Kaufman stated:

> [I]f we were paying for net worth, for the stocks and bonds themselves, it would have been irrational, in fact it was irrational, to think in terms of also multiplying the dividend income and the investment income. (123)

The deal that was discussed on October 2nd, however, did not involve a separate payment for the net worth. The $5,500,000 principal amount of notes issued to appellee was payment for his entire business, including the $1,300,000 securities portfolio. It would have been just as irrational to exclude the investment income in a deal where there was to be no separate payment for net worth as it would have been to include such income if there was to be a separate additional payment for the net worth.*

(11) The court's finding that the adjusted figures in Exhibit 3 were substantially accurate (S-35a-36a)

* * *

The court found it possible that upon reconstruction, using different methods, the figures in Exhibit 3 might not prove out to the dollar but the shrinkage, if any, would not be material. (S-35a)

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* Appellant's brief (p. 20) states that it was not buying appellee's investment "expertise". There is an obvious difference between expertise and $1,300,000 in securities. Appellant was buying the latter, not the former.

Aside from the investment income of approximately $50,000 in 1968, appellant questioned the validity of three items of adjustment: (i) pension overfunding; (ii) salary adjustment for Rose Dogan in the amount of $10,000 in 1968; and (iii) travel, entertainment, and other expense items.

(i) *Pension Overfunding*

Frank and Kaufman conceded that they were aware that, in the presentation to them, appellee had added back the amount of the pension contributions because in 1968 no pension payment was required since the plan was then overfunded. Nevertheless, appellant's expert witness, Rohn, ignoring the understanding of the negotiators with respect to the adjustments—which were retrospective, not prospective (see pp. 7-8, *supra*)—testified that he did not take into account a single dollar for the pension overfunding on two grounds: first, without knowing whether or not the pension plan was overfunded and, if so, the extent of the overfunding, Rohn assumed that there would have to be some pension contribution because pensions tend to be a continuing obligation (490), and second, appellee failed to make an adjustment for accrued vacation pay. (492)

Both of these reasons were patently specious. In preparation for testimony to be given in this litigation, appellant requested its actuary (Castrovinci) to determine what the pension requirements would have been on an accrual basis in 1968. The actuary supplied a letter (Exhibit 16) indicating that, on an accrual basis, the reasonable cost expected to occur on an annual basis would range from $15,000 to $30,000. (1393) In preparing Exhibit 16, Castrovinci had the impression that "it was not important" and that a "ball park number" would be sufficient. (823) Nothing was said in the letter as to what the obligation

was in the year 1968, but the same actuary's representation to the accounting firm of which Rohn was a partner is instructive on the validity of the pension adjustment. In that letter, Exhibit O (1694-5), Castrovinci stated that for the year 1971 the current service cost of the plan was $18,785. Moreover, in 1971 there were 60 employees (1694); in 1968 there were 33 employees. (1362) There was no service cost—no pension contribution—for the years 1969 or 1970 (567) and as of January 1, 1971 the value of accrued benefits (the liabilities of the plan) was $201,000 while its assets had a book value of $532,727 and a market value of $526,549. (1694)

Thus, the litigation-inspired effort to fix pension obligations at $15,000 to $30,000 is spurious. But, even assuming that some credence should have been given to Exhibit 16, it would have allowed for a pension adjustment of as much as $49,000 for 1968 ($64,000 minus $15,000). That adjustment appears nowhere in appellant's reconstruction of adjusted income because Rohn testified that it was offset by accrued vacation pay—an obligation fully disclosed to appellant. (545, 212a #73-1345) The vacation pay item was not taken into account in the preparation of Exhibit 2 because it was an accrual item and Exhibit 2 only dealt with cash adjustments. (1003) But even assuming that vacation pay accruals should have been adjusted, the amount of the adjustment would have been less than $5,000 a year, because the total vacation accrual liability assumed by appellant was $23,000 (Brief for Appellant at 24) and those accruals were built up over many years. In evaluating Rohn's testimony, it is worth noting that he *did* make an adjustment deducting from income $4,000 for accrued vacation pay for 1968 (1384), but, nevertheless, totally disallowed the pension adjustment which, even accepting Exhibit 16, should have been in the range of $50,000 added to income.*

* The court had additional reasons for rejecting Rohn's testimony (see pp. 40-42, *infra*).

(ii) *The Adjustment for Rose Dogan's Salary*

Rose Dogan had drawn a salary of $50,000 in the fiscal year ended in 1968. Under the acquisition agreement, her salary was to be $40,000. (393a #73-1345) This was discussed at the October 2nd meeting. (979) The summary thus assumed that had the acquisition taken place prior to 1968, there would have been a saving of $10,000.

(iii) *Travel, Entertainment and Other Expense Items*

Kaufman, Frank and McIntyre recognized that in a private business one frequently takes deductions in amounts larger than one takes in a public company. (977, 978, 1430, 1478, 1480) The parties agreed after discussion on October 2nd that the amount for which this item was to be adjusted was $37,000. (481a #73-1345)

(12) The court's finding that there was no false or misleading statement about the data processing capacity of the Faggen Companies (S-28a-29a)

* * *

The court found that neither Frank nor anyone else on behalf of appellant assumed or was told that the Faggen Companies had greater data processing capacity than actually existed. Appellant's brief (p. 39) distorts Exhibit 3 to suggest that it contains a representation that appellee had completed a data processing program which would enable it to service stock brokers, accountants and lawyers. Exhibit 3 explicitly described the equipment owned by the Faggen Companies. It states that "Harold Faggen Associates, Inc. . . . leases an IBM 360 Model 20 computer. The present system uses cards but two disc drives are on order and delivery is expected within the next few weeks".

(1369) The president of appellant's actuarial division testified that in 1968 the Faggen Companies had a limited computer program. (798-99) There was no statement that an automated program was in being (1012); an employee was, in fact, working on an automated program (1013); appellee had discussed the project with accountants, stockbrokers and others (1016); but was not making sales efforts. (1018) Frank himself testified that "Mr. Faggen *had the concept,* which I grew very excited about, of computerizing the capability of analyzing relatively small corporate pension funds and using that capability with almost no face-to-to face contact between the client and the actuary . . ." (279) [Emphasis supplied.]

Mr. Frank was knowledgeable in the field of computers. He surely knew that there was a considerable distance between having a concept and the development of that concept to the point that it becomes salable, let alone profitable. Mr. Frank knew, the capacity of a 360 Model 20 computer using cards. There is nothing in Exhibit 3 to suggest that a completed program had been developed or that the then computer capacity of the Faggen Companies would enable it, in any brief period of time, to complete the programs described in Exhibit 2. The record is abundantly clear that Frank knew that the programs decribed in Exhibit 2 were not "in being". Kaufman knew that Faggen would not expand except at the risk of another company and that he had no organization to solicit new business. (1377) Appellant blandly ignores the minutes of appellant's directors' meeting of October 9th at which the Faggen acquisition was approved. The minutes state that Frank disclosed to the Board that the Faggen organization "*expects to expand* into the computerization of actuarial processes which would be available for sale to insurance brokers and CPAs. *In order to enter this field* it would probably require the services of another 360-20 or 25 computer" [Emphasis supplied], (191a-192a

#73-1345) Those minutes demonstrate that appellant's brief is deceptive in asserting that Exhibit 3 represented that a program was "in being" for automated pension plan calculations (Brief for appellant at 39). In the two years following the closing, there is no record of a single complaint by Kaufman, Frank or any Board member who had approved the transaction to the effect that they had been misled about the computer capacity of the Faggen Companies. They were well aware that the expansion of the computer capability was to take place after the closing. Thus, for example, appellant's 1969 Annual Report—prepared sixteen months after the closing—refers to the "comprehensive and highly flexible computer program . . . being developed". (1526)

In the directors' minutes of July 15, 1970, Kaufman stated that "the Faggen organization's decline in earnings was attributed to decisions to invest in that organization's future in the data processing area". (425a #73-1345) Long before this lawsuit was invented by appellant's present Chairman of the Board, appellant considered that investment as an ordinary business risk which, of course, it was.

(13) The court's finding that there was no material misstatement or omission regarding customers (S-14a, 29a)

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On October 2nd, Kaufman and Frank went through the client ledger and they had the opportunity to examine all the accounts, including those that had been lost in the year prior to closing (1021-22).

The court found that appellant was not interested in specific customers, was aware that customers would be

lost in the ordinary course of business, and in fact did nothing when, within a month after the closing, a disgruntled employee (Tabor) left and pirated a number of customers of the Faggen Companies. (354-55, 434-35) For three and one-half years before the institution of this lawsuit, appellant was aware that these clients had been diverted.* For more than a year after Tabor's defection, Frank remained President and chief operating officer of appellant; Kaufman assumed the position of Director-Vice President of appellant shortly after the closing and five months later, in May 1969, he became Chairman of the Board and chief executive officer, which position he held until July 1970. Neither Kaufman nor Frank ever complained that there was any false or misleading statement regarding the clientele of the Faggen Companies.

(14) The court's finding that there was no material misstatement or omission regarding any relationship between appellee and Benjamin Robinson (S-30a)

Notwithstanding appellant's concession, on the record, that an alleged concealed conflict of interest of Mr. Robinson was not a 10b-5 claim (93), appellant now urges (Brief for Appellant at 42-44) that there was such a conflict and that it forms a basis under Rule 10b-5 for rescinding the contract. The court found that "no one

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* If, as the courts have held, laches is a defense in a Rule 10b-5 case, then it surely must bar a claim based upon Tabor's defection in December 1968 (*Baumel* v. *Rosen*, 412 F.2d 571, 574 (4th Cir. 1969), *cert. denied*, 396 U.S. 1037 (1970); *Ply-Gem Industries, Inc.* v. *Green*, CCH Fed. Sec. L. Rep. ¶94,026 (S.D.N.Y. June 15, 1973) at p. 94,128, *aff'd and rem.*, CCH Fed. Sec. L. Rep. ¶94,705 (2d Cir. July 9, 1974).

was bemused about the close relationship between Robinson and Harold Faggen." (S-30a) There is ample evidence that all concerned knew that appellee and Robinson had worked closely together (95-96) and that Robinson's law firm represented a number of funds in which the Faggen Companies did the actuarial work. (357) Indeed, appellant's brief concedes that Frank and Kaufman were aware that Robinson and appellee were friends, that both sat as consultants on some of the pension-welfare funds, and that Robinson's firm had represented appellee (289).

The record is clear that Kaufman negotiated this deal totally independent of Robinson; that Kaufman prepared the first draft of the contract (139), which did not differ materially from subsequent drafts (compare 1555-1623 with 1624-1665); that all subsequent drafts were redlined and transmitted to Kaufman for his approval. (250, 444-45) Robinson refused to participate in the negotiations (332); was not present during the critical negotiating session on October 2nd when the deal was struck (340); and was out of the country during most of the next two months when details of the contract were hammered out by the lawyers. (431) In short, the evidence bears out appellant's proxy statement that the transaction was arrived at as the result of arm's length negotiations. (1542) (see p. 11 *supra*).

(15) The court's finding that after the closing the actuarial business continued to be profitable (S-14a).

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The trial court's finding that the actuarial business continued to be strong is supported by appellant's own testimony. Appellant introduced a chart showing the total net income of the Faggen Companies in the years

following the closing. (1389) The president of the actuarial division testified as to the losses sustained in data processing. (816-17) The following chart demonstrates that the actuarial business continued to generate substantial profits until the year 1972, when this lawsuit was commenced.

Year	*Total Net Income of the Faggen Companies* (1389)	*Loss in Data Processing Operations* (816-17)	*Profits in Actuarial Div.*
1969	$260,000	$(138,000)	$398,000
1970	192,000	(284,000)	476,000
1971	136,000	(192,000)	328,000

Appellant also had the opportunity to invest more than $2,000,000 which it took from the Faggen Companies between 1969 and 1971, most of which was taken promptly after the closing. (see Finding 4, p. 22, *supra*).

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The court's ultimate findings of fact (Nos. 16 and 17, *supra*)—that appellant did not rely upon Exhibit 3 and that appellee made no materially false statements or omitted to state material facts necessary to make the statements made, in the light of the circumstances under which they were made, not misleading—were amply supported by the record and are discussed at Point II, *infra*.

On the basis of the evidence in support of the court's findings, it is manifest that such findings were without error.

POINT II

Appellant failed to establish any of the elements of its Rule 10b-5 case.

The trial court found that appellant failed to prove that the appellee was guilty of any scheme or artifice to defraud or that he made any untrue statement of material fact or omitted to state a material fact necessary to make the statements made not misleading.

The evidence is clear that Exhibit 2 was not false or misleading. The proof, through those who participated in the pre-contract negotiations, was that, on the basis of the income tax returns and adjustments thereto, the Faggen Companies' earnings were translated into those that appellant, a public company, might have achieved. Appellant's President requested that the validity of these adjustments be verified by appellant's Treasurer. (322) They were, and the Treasurer so testified. (1478-80)

In its proxy statement appellant stated that the transaction had been negotiated at arm's length and had been consummated after full investigation of the financial condition of the Faggen Companies. Since the proxy statement was accurate and true (see pp. 11, 34, *supra*) the complaint is sham.

Materiality

The trial court found that appellee made no material misstatements nor did he omit to state material facts. In determining whether the statements upon which the appellant relies were material, the crucial and undisputed fact is that appellant had before it the actual historical earnings of the Faggen Companies for the five years prior to

the transaction, and it was satisfied with these representations as to net income, all of which were concededly true.

Even if the summary delivered two months before the closing is deemed to be material, appellant failed to demonstrate the respect in which it was inaccurate or improper. The trial court found that appellant was well aware of the basis upon which the figures were prepared (see pp. 22-23, *supra*).

The definition of "materiality" in this Circuit is set forth in *List* v. *Fashion Park, Inc.*, 340 F. 2d 457, 462 (2d Cir.), *cert. denied*, 382 U.S. 811 (1965). A statement is material where "a reasonable man would attach importance [to the fact misrepresented] in determining his choice of action in the transaction in question."

In *Gerstle* v. *Gamble-Skogmo, Inc.*, 478 F. 2d 1281 (2d Cir. 1973), this Court stated that proof of materiality requires more than establishing that the plaintiff *might* not have entered into the transaction. The plaintiff has the burden of proving that it *would* not have entered into the transaction but for the claimed misleading statement. The court stated that the difference between "might" and "would" is more than mere "gossamer" because "when account is taken of the heavy damages that may be imposed, a standard tending toward probability rather than mere possibility is more appropriate". (478 F. 2d at 1302)

In this case, the appellant failed to prove the lower standard rejected by this Court in *Gerstle*. It did not even attempt to meet the *Gerstle* standard. Thus, neither Frank nor Kaufman nor any other director testified that the loss of some accounts prior to the transaction would have affected the decision to acquire the Faggen Companies; neither testified that he believed that the transaction was based upon the Faggen Companies having com-

pleted a computer program for a fully automated pension plan; there was no mention that the morale of one employee (Tabor) would bear on their decision to purchase.

The only dispute between appellee and these witnesses was on the issue of whether investment income was included. And on that issue, the court, having the opportunity to observe all of the witnesses, disbelieved Frank and Kaufman and believed appellee, whose testimony was corroborated by McIntyre's deposition.

The omission of the Exhibit 2 summary and the other matters referred to in Exhibit 2 from the contracts is the most persuasive proof that appellant attached no importance to Exhibit 2 in determining its course of action. Who better than Kaufman could know what was material to appellant? Kaufman was aware of the purpose of a representation and warranty provision in an acquisition contract. (251) Kaufman's draft asked for, and the final contract provided for, representations of historical income only. Kaufman testified that the first draft included all of the representations and warranties that he sought and after receiving and reviewing the revisions of the contracts found there was "nothing I need raise" with respect to the contracts. (250) The historical income was verified by appellant during the course of this litigation (p. 21, *supra*). Here, as in *Ply-Gem Industries, Inc.* v. *Green, supra,* "the persons involved in the transactions . . . were all sophisticated businessmen who dealt with each other at arm's length. They had at their disposal as advisers various experts in the legal, financial and accounting fields. They not only displayed considerable business acumen but attached to their contractual commitments formal safeguards and reservations of the most meticluous kind." CCH Fed. Sec. L. Rep. at pp. 94,118-19 Again, as in *Ply-Gem* there was an "attempt to rescind

[the] contract . . . after . . . years of uncomplaining operation and control . . . [based upon] afterthoughts designed . . . to obviate the fulfillment of [the] commitments under [the] formal agreement." (*Id.* at 94,118)

Appellant's brief analyzes the bottom line figures in Exhibit 3 as if they were financial statements which should have been prepared in accordance with generally accepted accounting principles. There is nothing which suggests that they were presented as such, nor was there a single witness at the trial who testified that the bottom line figures in Exhibit 3 constituted financial statements. Yet this Court is presented with pages of analysis showing the extent to which Exhibit 3 failed to comply with SEC accounting rules.* (Brief for Appellant at 13-14) The summary was not and could not have been a financial statement. Financial statements reflect past events. If Titan elected to overfund the pension plan, there would have been no saving. Similarly, if Titan elected to pay appellee the same salary he had received in 1968, there would be no saving. None of the authorities cited at pp. 18 and 19 of appellant's brief are apposite. *Republic Technology Fund, Inc.* v. *Lionel Corp.*, 483 F. 2d 540 (2d Cir. 1973), *cert. denied*, —— U. S. —— (1974);** *Bowman & Bourdon, Inc.* v. *Rohr*, 296 F. Supp. 847 (D.

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* The transaction in question was not subject to SEC accounting rules (See *Bresnick* v. *Home Title Guaranty Co.*, 175 F.Supp. 723, 724-5 (S.D.N.Y. 1959)).

** Appellant's brief (p. 22) citing *Republic*, asserts that it was entitled to better than "ball park" figures; appellant did not receive "ball park" figures; it received the tax returns which were verified as accurate down to the last dollar. It was satisfied to estimate on a "ball park" basis the savings that it could have achieved to increase the earnings had it taken over the Faggen Companies five years earlier.

Mass.) *aff'd,* 417 F. 2d 780 (1st Cir. 1969); *Value Line Fund, Inc.* v. *Marcus,* CCH Fed. Sec. L. Rep. ¶91,523 (S. D.N.Y. March 31, 1965), and *Royal Air Properties, Inc.* v. *Smith,* 312 F.2d 210 (9th Cir. 1962) all involved the use of misleading financial statements which were presented to the buyer and upon which the buyer expressly relied. In the instant case, the only financial statements supplied to appellant were those incorporated in the tax returns and delivered to appellant long before the transaction closed.

Appellant has contrived a strawman argument in stating that the bottom line figures did not comply with SEC requirements for financial statements. No one could legitimately claim that Exhibit 2 was intended to be a financial statement in compliance with Regulation S-X or with Accounting Principle Board requirements. The most cursory examination of the Exhibit 2 summary would disclose to the most unsophisticated investor that it was not a financial statement. It does not show gross revenues; it has no breakdown of expenses; it merely sets forth bottom line figures—under the caption: "Net Income-Pre Tax adjusted to basis which will prevail after acquisition". (1360)

Rohn, defendant's witness, attempted to attack the adjustments used in preparing Exhibit 2. Rohn's testimony, in general, was not accepted by the court (S-34a-35a) and for good reason. Rohn conceded that he made certain assumptions based upon the framework set by appellant's present counsel (548) and although he was not privy to the initial transaction, he made no attempt to ascertain the adjustments to which the parties agreed. (580) He admitted that if his assumptions were wrong his answers necessarily would also be wrong. (576) He disregarded pension overfunding, without making any

determination as to what the assets and the liabilities of the pension fund were even though he conceded that this would have to be done in order to determine whether the pension plan was overfunded (560) and despite the fact his accounting firm had in its files a letter dated January 18, 1972 (1694) indicating that as at December 31, 1970 the assets of the fund were $526,549 and the liabilities were $201,000 and even though he knew that in the three years preceding that letter appellant had made a total contribution of approximately $19,000 to the fund. (567) Rohn sought to justify the reconstruction of the Faggen Companies' income on an accrual basis, even though his partner had found that to be impossible (1682), and even though another of appellant's "expert" accountants conceded that his partner was right. (647) Rohn also was willing to indicate on a document which he submitted to the court that the value of the marketable securities of the Faggen Companies was $1,076,000 (581, 1390) even though the records of the corporation, as verified by Peat Marwick Mitchell & Co., showed marketable securities with a value of $1,386,000 as at December 31, 1968. (582, 791-92) He did this by ignoring treasury bills having a market value of $175,000 and by arbitrarily reducing the value of Titan stock held by the Faggen Companies. (583, 602)

Finally, Rohn unashamedly evaluated the Faggen Companies as of the acquisition date at $1,300,000 to $1,900,000 notwithstanding: (a) the Faggen Companies had cash, marketable securities and other current assets of almost $2,000,000;* (b) his own litigation inspired re-

* Exhibit J (1677), which was prepared by appellant's accountants, shows the net worth of the Faggen Companies as at September 30, 1968 to be $1,316,834. But that figure is based upon a valuation of the securities portfolio at cost—$984,329. Exhibit J shows that the market value of the portfolio was $1,300,007. Thus, the true net worth as at September 30, 1968 was $1,632,501. Characteristically, there is no record reference for appellant's assertions that the Faggen Companies' net worth was only $1,000,000 (Brief for Appellant at 47).

construction of income for the year 1968 shows net income after state and city income taxes of $404,000 (excluding income derived from the securities portfolio and disregarding pension and other adjustments) (1384); and (c) his own accounting firm certified that for the years 1971 and 1972, the cost of the Faggen Companies in excess of the net assets (approximately $4,000,000) was not being amortized because it was believed to have continuing value (945-46, 951-52). If Rohn's assessment was valid, appellant should have written off the 4,00,000; stating it plainly: while his own accounting firm was certifying to the SEC and the public that the Faggen Companies had a value of $5,500,000, Rohn was swearing that it was worth not more than $1,300,000 to $1,900,000.

* * *

Although the other claims of false and misleading statements were almost summarily dismissed by the trial court on a finding that they bordered on the absurd (S-20a), appellant devotes some 25% of its brief to those claims. These include: (1) statements relating to the computer program; (2) statements relating to the client list; and (3) alleged conflict of interest.

Computer Program

Appellant asserts that Exhibit 3 was misleading in its statement that the Faggen Companies had actuarial and computer capacity and were in the process of programming completely automated pension plan calculations for small and medium sized employers. Appellant's distortion of Exhibit 3 is discussed at pp. 30-32, *supra.*

Client List

Appellant charges (Brief for Appellant at 31 *et seq.*) that Exhibit 3 was misleading in representing the number

of current and previously acquired clients of the Faggen Companies and asserts that appellee had the duty to state that some clients had been lost in prior years and to forewarn that a disgruntled employee might, in the future, leave. The disgruntled employee (Tabor) left two weeks after the closing (434-35), taking with him clientele producing gross fees before expenses of approximately $109,000 per annum. (1397) He and his new employer were sued and the Faggen Companies recovered more than $250,000. (355) Neither Frank nor Kaufman then remonstrated that he had been misled. Nor did appellant attempt to prove through any witness who participated in the transaction that appellant ever regarded the loss of clients by defection or otherwise as a deception. On October 2nd Frank and Kaufman went through the client list which disclosed the identities of each of the clients and the client accounts that had been lost as well as gained. (1021-22)

Egregiously disregarding business reality, appellant attributes 10b-5 culpability for an *after* acquisition loss during 1969 and 1970 of forty clients with a total billing of about $300,000. Appellant's brief (at pp. 37-38) ignores the admission by Castrovinci, the president of its actuarial division, that in the same period it obtained a single client whose billing exceeded that of the lost forty clients and that the volume of actuarial business did not decline after acquisition. (811, 819-20) Castrovinci also testified that the business sold to the appellant—the business of providing actuarial services for pension and welfare funds—was a growth industry in 1968 and it still is. (821)*

* As noted above, (p. 35, *supra*), the earnings of the actuarial division held up until appellant's current chairman, Robert Frankel, began his campaign against appellee. A reflection of the thinness of appellant's case is its heavy reliance on Exhibit 8, a projection of income that assumed that the past growth rate would continue. Exhibit 8 was given to Robinson *after* the closing (997-8). It was never discussed with or shown to the Board of Directors. It thus could not have had any bearing on appellant's decision to enter into the transaction.

Finally, neither Kaufman nor anyone else on behalf of appellant requested any representation or warranty with respect to clients.

The Alleged Conflict of Interest

During the trial, Judge Tyler referred to the alleged conflict of interest by the Robinson firm as "a lot of dubious razzmatazz". (623) In substance, the appellant asserts that Robinson was in appellee's "pocket" (Brief for Appellant at 43); that because of Robinson's relationship to Faggen there was a "mechanical handling" of the contract by Rosen, Robinson's associate (Brief for Appellant at 43) and that Leonard Casey, a director of the appellant and a Vice President of The Chase Manhattan Bank, voted for the acquisition because the appellee had directed some business to The Chase Manhattan Bank. (Brief for Appellant at 42)

The fact is that Kaufman and Frank were both well aware of Robinson's relationship with appellee. Because of that relationship, Robinson did not participate in negotiations (see pp. 33-34 *supra*).

Rosen, who worked on re-drafts, conferred with a senior partner, Aronsohn, and with Kaufman with regard to the changes. (418) Utterly irresponsible is appellant's insidious implication that Rosen prostituted himself because of his senior partner's relationship with appellee.

As for the charge that Casey's vote was bought, he didn't even know appellee at the time of the acquisition and nothing about his vote related to potential business for The Chase Manhattan Bank. (520) The only reason that business was directed to The Chase Manhattan Bank was that its rates were lower. (620)

Reliance

The court held that appellant was required, but failed, to prove reliance.

Appellant's attack on the issue of reliance is to assert either that by the facts of this case it was not required to prove reliance (Brief for Appellant at 44), or that if proof was required, it satisfied its burden. (Brief for Appellant at 46) Appellant is wrong on both counts.

As to the first of its contentions, and contrary to the allegations in its complaint that there was a representation of net income, that the representation was false, and that it was "relied upon by Titan" (9a, #73-1345), appellant argues that this is a non-disclosure case. The argument is without merit. None of the elements of appellant's case involved non-disclosure. Thus, appellant claims that the Exhibit 3 summary of income was overstated, that the number of clients reflected therein was inaccurate, and that the computer capacity of the Faggen Companies was described improperly. Appellant's argument would erase entirely the distinction between a false statement and an omission to state material facts; it would eliminate reliance from every 10b-5 case. By appellant's logic, every 10b-5 case is a non-disclosure case because where there is an alleged false statement there is necessarily the non-disclosure of the true facts. And, according to appellant, in all non-disclosure cases proof of reliance is unnecessary.* In *Affiliated Ute Citizens* v. *United States,* 406

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* Even if *arguendo,* this were deemed to be a non-disclosure case, reliance would still be an element. The *Ute* case did not eliminate reliance in all non-disclosure cases but, as stated in *Vohs* v. *Dickson,* CCH Fed. Sec. L. Rep. ¶94,589, at p. 96,072 (5th Cir. June 7, 1974), the Supreme Court held that:

(Footnote continued on following page)

U.S. 128 (1972) and *Shapiro* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, CCH Fed. Sec. L. Rep. ¶94,473 (2d Cir. April 3, 1974)—the cases relied upon by appellant—there was total non-disclosure of material facts in contexts where it was not feasible or reasonable to establish reliance. In *Ute,* the plaintiff class consisted of several hundred poorly educated Indians whose stock was purchased without any disclosure of the true market price and without disclosure that the purchasers were market makers. In *Shapiro,* a class of public investors "comprised of uninformed outsiders" (p. 95,660) purchased Douglas Aircraft stock while tippees with insider knowledge of adverse facts were selling.

In both *Ute* and *Shapiro,* the defendants had a superior position in that they possessed inside knowledge which they withheld from the plaintiff class. No comparable circumstance was present here. This was not a class action. The appellant was not an uninformed investor; it was more sophisticated than appellee (see p. 21, *supra*). It had the historical earnings figures and it had the opportunity to, and did, investigate those figures.

Reliance in the context of this case is syonymous with proof of causation in fact. (See Comment, *Causation and Liability in Private Actions for Proxy Violations,* 80 Yale

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(Footnote continued from preceding page)

> proof of *specific* reliance on particular omissions [is] unnecessary when the circumstances indicate that the plaintiff placed some *general* reliance upon the defendant's disclosing material information.

Since appellant did not place general reliance upon defendant's disclosure of material information but rather investigated the Faggen Companies and, in addition, sought and secured specific contractual representations in the very areas in which it claims appellee misled it, appellant cannot claim that it was relieved of its burden of proving specific reliance on the alleged omissions.

L.J. 107, 137 (1970)). Causation in fact is a basic element in a 10b-5 case, i.e., did the alleged misstatement or omission cause the damage which the plaintiff alleges? *Chris-Craft Industries, Inc.* v. *Piper Aircraft Corp.*, 480 F.2d 341, 373 (2d Cir.) *cert. denied,* 414 U.S. 919 (1973). Causation involves the element of reasonable or justifiable reliance upon the alleged misrepresentation (*Kohn* v. *American Metal Climax, Inc.*, 458 F.2d 255, 288 (3rd Cir.), *cert. denied,* 409 U.S. 874 (1972); and materiality, (*List* v. *Fashion Park, Inc.*, 340 F.2d 457, 463 (2nd Cir.), *cert. denied,* 382 U.S. 811 (1965). Reliance will not be inferred or presumed in the circumstances of this case.

Chris-Craft Industries, Inc. v. *Piper Aircraft Corp., supra,* 480 F.2d at 314, made it abundantly clear that *Affiliated Ute* did not eliminate reliance as an element in a face-to-face negotiated transaction. See also *SEC* v. *Lum's Inc.*, 365 F. Supp. 1046, 1059 (S.D.N.Y. 1973); *Landy* v. *Federal Deposit Insurance Co.*, 486 F.2d 139, 170 (3rd Cir. 1973), *cert. denied,* —— U.S. —— (1974).

In transactions between knowledgable parties, the courts have required not only actual reliance but have even placed upon the plaintiff an affirmative duty to investigate.* The reason for this was perhaps best expressed by this court in *Radiation Dynamics, Inc.* v. *Goldmuntz*, 464 F.2d 876 (2d Cir. 1972):

> [Rule 10b-5] was not intended to provide an escape hatch from which disgruntled buyers or sellers could avoid transactions to which they had become committed . . . .

464 F.2d at 891.

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* See, *e.g.*, *Clement A. Evans & Co.* v. *McAlpine,* 434 F.2d 100, 104 (5th Cir. 1970), *cert. denied,* 402 U.S. 988 (1971). Appellant's former special counsel was of the opinion that: "Since Faggen's position was adverse to that of Titan's, Titan had an affirmative obligation to make its own investigation and cannot rely upon representations made by Faggen." (1666)

Where the parties are sophisticated, have general business experience and expertise, are acquainted with the affairs of the corporation whose securities they purchase, have access to the information alleged to be misrepresented, and where there is no fiduciary relationship between buyer and seller, the plaintiff has an especially heavy burden in establishing its reliance. Note, *Reliance under Rule 10b-5: Is the "Reasonable Investor" Reasonable?*, 72 Colum. L. R. 562, 567 *et seq.* (1972). Cases illustrating this principle and denying relief to sophisticated plaintiffs in carefully negotiated transactions include: *Kohner* v *Wechsler*, CCH Fed. Sec. L. Rep. ¶93,537 (S.D. N.Y. June 10, 1972), *aff'd as modified*, 477 F.2d 666 (2d Cir. 1973); *Ply-Gem Industries, Inc.* v. *Green*, CCH Fed. Sec. L. Rep. ¶94,026 (S.D.N.Y. June 15, 1973), *aff'd, and rem.*, CCH Fed. Sec. L. Rep. ¶94,705 (2d Cir. July 9, 1974); *Kohler* v. *Kohler Co.*, 208 F.Supp. 808 (E.D.Wisc. 1962), *aff'd*, 319 F.2d 634 (7th Cir. 1963); *City National Bank* v. *Vanderboom*, 422 F.2d 221 (8th Cir. 1970); *Clement A. Evans & Co.* v. *McAlpine*, 434 F.2d 100 (5th Cir. 1970), *cert. denied*, 402 U.S. 988 (1971); *Niedermeyer* v. *Niedermeyer*, CCH Fed. Sec. L. Rep. ¶94,123 (D. Ore. August 21, 1973). *See also*, Bromberg *Securities Law: Fraud SEC Rule 10b-5*, §§ 4.4,8.3.

As the court stated in *Kohn* v. *American Metal Climax, Inc., supra*:

> [T]he realities of the business world must be considered in formulating an appropriate rule of culpability for the operation of 10b-5.

458 F.2d at 287.

Here, the appellant employed highly qualified lawyers, was represented by sophisticated business men, had avail-

able to it all the tools of the accounting profession, fully investigated the business it acquired, negotiated comprehensive contracts containing every representation and warranty that it considered necessary for its protection, and conceded that the representations and warranties were true. To predicate liability under these circumstances would make every party to a contract involving securities an insurer.

In its alternative contention, i.e., that it proved reliance, appellant argues (Brief for Appellant at 47-48) that the court erred in finding that appellant did not rely on the summary of adjusted earnings contained in Exhibit 2. It contends that each Board member relied on the earnings reflected therein. This contention is a distortion of the court's finding (see pp. 23-24, *supra*) and is not borne out by the evidence.

Robinson stated that the earnings were subject to the examination of the appellant's treasurer. (367) Frager stated that the contract was subject to the investigation of the Executive Committee into the financial details. (396) Frank knew the earnings had to be verified and he instructed McIntyre to verify them (316, 322, 1468), which McIntyre did. (1478, 1480) Casey looked to the Executive Committee to determine profitability before acquisition. (521) Not a single director present at the meeting at which the transaction was approved indicated that he relied on appellee's earnings as presented by Frank. Each of them required or assumed an independent investigation. Significantly, the minutes are silent as to precisely what Frank told the Board and the earnings figures recalled by the directors vary from \$450,000 to \$550,000: Robinson, over \$500,000 (331-32); Casey, \$550,000 (516); Frager, \$550,000 (390-91); McIntyre, \$550,000 (1471); Grunebaum, \$450,000 to \$500,000 (588); Frank, \$550,000, (284)

Exhibit 3 was not distributed at the directors' meeting and not one of the directors present recalled being told that the earnings were $571,000, the figure shown on Exhibit 3. Frank did not even recall whether he told the Board that appellee's earnings were on a restated basis. (305-313) Clearly, the Board was acting on Frank's presentation, not appellee's memorandum. In short, every Board member approved the transaction—not in reliance on appellee's statement—but in reliance on the investigation by appellant's Executive Committee.

Finally, what about the contracts? Each director knew that contracts would have to be executed. Each of them relied on the appellant's staff and counsel to assure that appellant was protected.

Appellant received every representation and warranty, which it sought, including detailed statements of historical earnings for a period of five years, which statements were verified dollar for dollar (see p. 21, *supra*). Appellant made its own investigation of the earnings of the Faggen Companies and it so advised its stockholders in the proxy statement prepared or reviewed by the experienced SEC lawyer who negotiated the transaction. And, of course, Frank testified that the proxy statement was true, which it was.

Scienter

A third element in a 10b-5 case which appellant was required and failed to prove is scienter. Scienter was defined most recently by this court in *Lanza* v. *Drexel & Co.*, 479 F.2d 1277, 1306 (2d Cir. 1973) as "willful or reckless disregard for the truth." Appellant implies scienter in the preparation of Exhibit 2 by disputing some items of adjustment which went into the preparation of the ad-

justed earnings summary contained therein. These disputes relate to the validity of adjustments for pension overfunding, travel, entertainment and other expense items, and salaries.

Kaufman was aware of the nature of these adjustments (255 *et seq.*), as was Frank (278); and appellant had ample opportunity to check them against the books and records of the Faggen Companies. As the trial court observed, appellant's own experts ascertained that the net income of the Faggen Companies was in excess of $400,000 in 1968. (35a) That figure was arrived at with assumptions supplied not by the principals who negotiated the transaction but, rather, by appellant's trial counsel. (548)

* * *

It is absurd for appellant to charge appellee with fraud when in December 1968 it received from appellee far more value than it gave.

The Faggen Companies had liquid assets of almost $2,000,000 including a securities portfolio of more than $1,300,000 which was turned over to the appellant soon after the closing; the actuarial business was a thriving business which continued to thrive after the closing; it produced annual income substantially in excess of $350,000 before and after the closing and permitted appellant to withdraw $700,000 in cash prior to the institution of this action. It had growth potential (821) and was highly regarded as a leader in its field. (1526)* In return for this business and these assets, appellee received no cash whatever. He was given instead low grade corporate

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* The trial court in its supplemental opinion observed that although the notes may have only been worth $3,200,000 "[i]t cannot be said . . . that at the time of the sale, Faggen's business was not in fact worth $5,500,000 to Titan." (64a)

notes, whose value at the time of the transaction was not more than $3,200,000. (964-970, 1724-1730)*

Ultimately, neither fact—the value of the business of the Faggen Companies nor the value of the notes issued in return therefor—is relevant. What is relevant is that each party got what he bargained for—and the appellant got what it bargained for after full investigation of the facts.

In sum the trial court's conclusion that a 10b-5 case was not proven was amply supported by the evidence.

POINT III

Default on promissory notes warranted judgment in the amount provided for by their terms.

The appellant conceded that it had defaulted on the notes issued to appellee and that appellee in compliance with the terms of the notes had served, and appellant had received, due notice of default which was not cured. (102) On these conceded facts, the statute is dispositive on the propriety of the judgment. See N. Y. Uniform Commercial Code §§ 3-106(e) and 3-109(1)(c).

> The established remedy against a debtor for his breach of a contract to pay a sum certain in dollars of the legally established currency is a judgment for the exact principal sum in dollars, with interest at some legally fixed rate from maturity.

5 Corbin on Contracts §1005, at 52 (1964 ed.).

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* Appellant, in Point I of its brief, assumes that the notes were the equivalent of $5,500,000 in cash (see *e.g.*, Brief of Appellant at 47). At Point II, however, it acknowledges that the value was in fact $3,200,000 or less.

Appellant constructs a strawman by its contention that the acceleration of the notes resulted in a judgment for unearned interest. In support thereof it cites *Northtown Theatre Corp.* v. *J. J. Mickelson*, 226 F.2d 212 (8th Cir. 1955) for the proposition that unearned interest is not recoverable. Unearned interest is not an issue in this case. Appellee's judgment is for the "exact principal sum in dollars, with interest from maturity" (the notes matured upon default).

The essence of appellant's argument is that since it issued notes worth only $3,200,000, the difference between this amount and the face amount was unearned interest. Thus, appellant completely disregards all of its own contentions that it bought appellee's business for $5,500,000 and that this was the price it promised to pay. Since it cannot prevail on its claim of fraud, it would avoid its promise to pay the bargained for price.

The law is clear that acceleration of notes in accordance with their terms is not a penalty. See *Manufacturers Trust Co.* v. *Hollinger,* 141 N.Y.S.2d 795, 797 (Sup. Ct. 1955); 5 Corbin on Contracts §1065, at 376 (1964 ed.).

The liquidated damage cases cited at page 57 of appellant's brief are patently inapposite. The district court rendered judgment because appellant failed to honor promissory notes issued for value. None of the liquidated damage cases suggests that such notes should be rewritten by a court.

Absurd is appellant's argument that because appellee accepted notes with a then cash value of $3,200,000 in 1968, appellee is entitled to recover only the then value (or something less). The enforcement of appellant's concepts would make a shambles of the world of commerce. Ap-

pellee did not receive $3,200,000 in 1968; he received notes in the principal face amount of $5,500,000, and appellant defaulted on those notes. Every day there are issued notes, bonds, mortgages and debentures whose principal face amount is more or less than the then market value. Courts do not require a purchaser of such an instrument to prove its value in enforcing the debtor's obligation to pay what it promised.

Appellant argues (Brief for Appellant at 59 *et seq.*) that the commencement of an action, which was purportedly based upon a violation of the securities laws, in some manner relieved it of its obligation to make payment on the notes.* There is nothing in the cases relied upon by appellant remotely suggesting such a bizarre meaning of Section 29 of the Securities Exchange Act. Appellant was not required to default as a prerequisite to filing its rescission action. If appellant's view of the law were correct then any debtor short of funds to meet its obligations could commence an action purportedly based upon the securities laws and thereby obtain a moratorium.

Appellant Had Its Day In Court

Appellant distorts prior proceedings in asserting that the bifurcated trial deprived it of its right to prove setoff and that the court below and this court sanctioned its default. (Brief for Appellant at 58-59)

The bifurcated trial was to permit a hearing on damages only in the event that appellant prevailed. (1226) It was

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* Paragraph 3 of the notes (1739) provided for redemption at the option of the appellant by payment of a premium. Appellant's claim would, of course, permit it, by defaulting, to redeem the notes at a substantial discount.

recognized that (a) the principal amount of the notes was a liquidated sum, and (b) rescission, five or six years after the acquisition, was not a feasible remedy even if appellant proved its case. Appellant's theory that it was entitled to reform the contract so as to limit appellee's recovery to $3,200,000 was thought up by its counsel "at lunch" (1185), after his summation and immediately before the court rendered its decision.

Appellant never sought to plead set-off and its assertion that Judge Ryan determined that "$1 million claim of setoff constituted evidentiary matter which could be properly asserted in reduction of any sums recoverable by defendant Faggan" (Brief for Appellant at 62) is untrue.

Prior to trial, appellant moved to amend its complaint (538a, 557a-65a, #73-1345)—*not its reply* (38a, #73-1345)—to add four additional counts. Judge Ryan in a memorandum endorsement dated June 22, 1973 (3a), denied the motion, stating:

> The four causes of action which Titan would add to this suit are pleaded in somewhat rambling fashion and are but a resume and recital of evidence which Titan may offer in evidence under its present complaint. To permit these duplicitous counts to be added would serve only to hamper the orderly presentation of the evidence.
>
> These additional counts are based on a claim that there was a secret consideration paid to Titan's Chairman of the Board, Benjamin Robinson, in September, 1968, at the time of the acquisition of the Faggen companies. This Titan claim is established by the fact that Faggen was able to convince one of his actuarial clients to hire Robinson's law firm, which received some $250,000 in fees since Sep-

> tember, 1968. It is also alleged that Faggen did not tell Titan of the depletion of a list of clients and business. But all of this is evidence admissible under the present pleadings.

Judge Tyler permitted proof to be offered on the matters alleged in the proposed amended complaint. Appellant conceded that the trial court did not cut him off on these issues and was "very fair". (1231) In fact, appellant's brief is replete with references to the evidence on those matters. Appellant had its day in court on the issues it framed and, after putting in it entire case, it rested. The court found that it failed to prove its case and judgment on the notes automatically followed.

Appellant's counsel's trial strategy was binding upon it.

> A lawyer must be able to determine questions of strategy during trial; and unless there are exceptional circumstances or unless the lawyer is so incompetent as to deprive the defendant of the right to effective assistance of counsel, his decision regarding trial strategy must be binding.

U. S. ex rel Cruz v. *La Vallee,* 448 F.2d 671, 679 (2d Cir. 1971), *cert. denied,* 406 U. S. 958 (1972).

In *Rue* v. *Feuz Const. Co.,* 103 F.Supp. 499, 502 (D.D.C. 1952), the court, in denying a motion to reopen, stated:

> It is the view of this court that failure of a party to call available witnesses to meet issues raised at the trial does not constitute justification for reopening a case after determination by the court. Public policy and the court calendar are such as not to permit a party litigant to gamble on reliance on one theory at the trial and, after a contrary view of the evidence is adopted by the court and is to be followed in its judgment on the facts of record, to

seek to reopen the case to meet the other issues raised by that record, in an attempt to make for a finding in its favor on the theory adopted by the court.

As to appellant's contentions that Judge Ryan and this court both sanctioned its failure to pay interest installments on the notes (Brief for Appellant at 58-59), the facts are as follows: Shortly after the commencement of the action appellee moved for a temporary mandatory injunction directing payment of interest *pendente lite.* Judge Ryan held that appellee was entitled to a prompt trial and he thereby effectively granted relief under Rule 65 Fed. R. Civ. P. When, notwithstanding Judge Ryan's decision, appellee could not get a prompt trial, he appealed from the decision relating to the preliminary injunction. On the argument of that appeal, Chief Judge Kaufman asked appellee's counsel whether he was, in fact, seeking a prompt trial, and whether a direction from this court requiring a prompt trial would satisfy him. When appellee's counsel responded affirmatively, this court, from the bench, affirmed Judge Ryan's decision below and directed that a trial commence not later than January 1974. According to appellant, this sanctioned its unilateral decision to withhold interest on the notes.*

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* Appellant's decision to withhold interest was outrageous in light of the fact that it had derived more than $2,000,000 from the Faggen Companies during its ownership and had paid appellee some $660,000 in interest during that period of time. Thus, even if it were entitled to full rescission, it would owe substantially more than the interest payments which would have been paid during the lawsuit. As a matter of fact, *after* the trial, appellant's counsel made the following concession: "Your Honor, the case was always what Titan owed Faggen. We always owed him something. We always owed him two million dollars. That was conceded in the papers." (1239) We submit that appellant withheld the interest payments solely as a device to bludgeon appellee into converting his notes into stock.

It is, of course, axiomatic that the grant or denial of a motion for preliminary injunction is not a determination of the merits. *Benson Hotel Corp.* v. *Woods,* 168 F.2d 694, 698 (8th Cir. 1948).

CONCLUSION

The findings and conclusions of the court below are fully supported by the evidence. The judgment below should be affirmed.

Respectfully submitted,

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ITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

an Group, Inc.,
Plaintiff-Appellant,

against

d Faggen,

Defendant-Appellee

AFFIDAVIT OF SERVICE

OF NEW YORK,
Y OF New York , ss:

l S. Greenberg being duly sworn,
es and says that he is over the age of 21 years and resides at
162 East Seventh Street, New York, N.Y.
hat on the 9th day of September 19 74 at
110 East 59th Street, New York, N.Y.
ved the annexed Brief for Appellee upon
Powers & Gross,
s action, by delivering to and leaving with said Powers & Gross
three true copies thereof.

EPONENT FURTHER SAYS, that he knew the person s so served as aforesaid to be the
mentioned and described in the said action.

ent is not a party to the action.

to before me, this 9th
September 19 74

Bernard S Greenberg

Roland W. Johnson

ROLAND W. JOHNSON
Notary Public, State of New York
No. 4509705
Qualified in Delaware County
Commission Expires March 30, 1975